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No. 20,537

In the United States Court of Appeals for the Ninth Circuit

ALBERT J. WILD

and

AIR CONDITIONING SUPPLY CO., INC., APPELLANTS

v.

UNITED STATES OF AMERICA, BENNETT Y. BREWER, Special Agent

and

VALLEY NATIONAL BANK, APPELLEES

On Appeal from the Order of the United States District Court for the District of Arizona

BRIEF FOR THE UNITED STATES AND BENNETT Y. BREWER, SPECIAL AGENT

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OPINION BELOW

The decision of the District Court (I R. 88-90)[1] has not been officially reported.

[1] "I R." references are to Volume I of the record on appeal, which is the court file.

JURISDICTION

This appeal involves the enforcement of an Internal Revenue summons. The Government commenced the instant action to enforce the summons pursuant to Section 7604(a) of the Internal Revenue Code of 1954. (I R. 1-3.) On July 12, 1965, the District Court entered an order to show cause why the summons should not be enforced. (I R. 8.) On July 23, 1965, the appellants moved to intervene in the action (I R. 18-19), and on July 28, 1965, they were granted leave to intervene (I R. 36). A hearing was held on July 28, 1965. (II R. 1-69.[2]) The court ordered enforcement on September 23, 1965 (I R. 88), and the intervenors filed their notice of appeal on October 7, 1965 (I R. 99). The respondent to the summons filed no notice of appeal. This Court's jurisdiction is invoked under 28 U.S.C., Section 1291.

QUESTIONS PRESENTED

1. Whether a special agent may issue an Internal Revenue summons in support of an investigation to ascertain the correctness of tax returns which could lead to a criminal prosecution.

2. Whether the Government's showing of materiality and relevancy was sufficient to support the court's determination that the summons should be enforced.

3. Whether the action was properly commenced procedurally.

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[2] "II R." references are to Volume II of the record on appeal, which is the transcript of the hearing of July 28, 1965.

STATUTE, RULES, AND REGULATION INVOLVED

Section 7602 of the Internal Revenue Code of 1954, Treasury Regulations on Procedure and Administration (1954 Code), § 301.7602-1(a) and (c) (4), and Rules 1, 2, 3, 8(a) and 81(a)(3) of the Federal Rule of Civil Procedure are set forth in the Appendix, *infra*.

STATEMENT

In its petition (I R. 1-3) to enforce the instant Internal Revenue summons, the Government alleged, in relevant part, that Special Agent Brewer has been conducting an investigation of the tax returns of the appellants, Albert J. Wild and Air Conditioning Supply Co. (hereinafter referred to as taxpayers), for the years 1960 through 1962, in order to determine the correctness of those returns.[3] (I R. 1.) In furtherance of this investigation the instant summons (I R. 6-7) was served on the Valley National Bank (hereinafter referred to as the bank), calling for production of certain records reflecting loan and credit transactions it had with the taxpayers, which records would have a direct relation to their tax returns for the years involved. (I R. 2.) A preliminary injunction was thereafter issued prohibiting the bank from complying with the summons until such time as the District Court might order it to be enforced.

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[3] The investigation began in 1963, and this Court affirmed the enforcement of an earlier summons for the production of the corporate taxpayer's books and records. *Wild* v. *Brewer*, 329 F. 2d 924, certiorari denied, 379 U.S. 914.

Attached to this petition was the affidavit of Agent Brewer, alleging that the instant summons was issued to secure records in support of, and which were necessary to, his investigation of the correctness of taxpayers' tax returns for the years 1960 through 1962. (I R. 4.)

In their amended answer to this position (I R. 33-34), the taxpayers [4] denied that Agent Brewer was investigating the correctness of their tax returns, and alleged that he was actually conducting an investigation for the purpose of prosecuting or preparing to prosecute a criminal case against them. They also denied that Agent Brewer was authorized to issue summonses, and that the records sought had any relevance to the correctness of their tax returns. By way of affirmative defenses the taxpayers alleged that the petition failed to state a claim, that the records were not described with sufficient certainty, that production of the records would violate the taxpayers' Fourth and Fifth Amendment privileges, that the Government has not shown probable cause why the summons was issued or should be enforced, and the records sought had no relevance to any authorized investigation.

The case was heard before the District Court on July 28, 1965. (II R. 1.) Agent Brewer testified that he had been assigned to investigate taxpayers' tax liabilities, and that he had issued the summons to the bank to obtain loan records reflecting transactions

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[4] We are not concerned with the bank's response to this petition (I R. 25-27) in this appeal, for it has not filed any notice of appeal and is just a nominal appellee in this Court.

with the taxpayers. (II R. 47, 49.) Agent Brewer testified that he had previously examined the bank's central liability control sheets, which indicated that six or seven loans, approximating $75,000, had been made to the corporate taxpayer, whereas the corporation's books reflected only two loans in this period totalling $6,000. (II R. 50-53.) He testified that he wanted to examine the detailed records called for in the summons in order to obtain specific facts and figures to use in attempting to reconcile this discrepancy. (II R. 50.)

The other witness called by the Government was the custodian of the bank's credit files. (II R. 55.) He produced xerox copies of the summoned records in court and testified that they were kept in the ordinary course of the bank's business. (II R. 55-56.) He further testified that all of these records, except for the financial statements of the corporate taxpayer, had been generated by the bank. (II R. 57-58.)

Neither the bank nor the taxpayers cross-examined either witness or offered any evidence. The court took the case on briefs (II R. 68), and on September 23, 1965, ordered the bank to comply with the summons. (I R. 88-90.)

SUMMARY OF ARGUMENT

It has been held in every circuit which has considered the question, including this Court, that the Internal Revenue Service is authorized to investigate to ascertain the correctness of tax returns, and to issue

summonses in support of such investigation, even though the investigation could well lead to a recommendation for criminal prosecution. Indeed, it has been so held even where taxpayers have, in fact, been indicted subsequent to the issuance of a summons but prior to the final conclusion of the litigation concerning its enforcement. Any other rule would encourage and sanction stalling tactics. No proper Constitutional question is presented in the instant case because the records sought all belong to and are in the hands of the bank, which has not appealed, and a bank's customer has not rights or privileges concerning its records.

The Government made a proper showing of the materiality and relevancy of these records, which concerned financial transactions between the taxpayers and the bank. The lower court's factual finding on this point is supported by the facts in the record and the reasonable inferences to be drawn from them, and should be affirmed.

This Court has recognized that the Federal Rules of Civil Procedure provide that the District Court may waive their application in a case of this nature, and the court below may properly be deemed to have waived them in sanctioning the fact that the instant action was begun by filing a petition. Moreover, the petition meets all of the requirements for a complaint, and the District Court correctly held that it could be treated as such.

ARGUMENT

I.

The District Court Properly Held That A Special Agent Could Issue An Internal Revenue Summons In Furtherance of An Investigation To Ascertain the Correctness Of Tax Returns Which Could Lead To A Recommendation For Criminal Prosecution

It is well settled in this and every other circuit which has considered this question that Section 7602 of the 1954 Code, Appendix, *infra*, authorizes the Secretary or his delegate to issue an Internal Revenue summons in any investigation to ascertain the correctness of a return or to determine tax liability, even though the investigation could well conclude with a recommendation for criminal prosecution. *Boren* v. *Tucker*, 239 F. 2d 767, 772-773 (C.A. 9th); *In re Magnus, Mabee & Reynard, Inc.*, 311 F. 2d 12, 16 (C.A. 2d), certiorari denied, 373 U.S. 902; *Siegel* v. *Tyson*, 331 F. 2d 604 (C.A. 5th); *Tillotson* v. *Boughner*, 333 F. 2d 515, 516-517 (C.A. 7th), certiorari denied, 379 U.S. 913; *Wright* v. *Detwiler*, 345 F. 2d 1012 (C.A. 3d).[5]

A special agent is expressly made one of the Secretary's delegates for this purpose. Treasury Regulations on Procedure and Administration (1954 Code),

[5] Although the *per curiam* opinions in the *Siegel* and *Wright* cases, *supra*, do not set forth their facts, each involved an attack on the validity of an Internal Revenue summons issued by a special agent based on the same contention as the instant one. Both courts found this proposition so utterly lacking in merit that they came down with extremely quick *per curiam* opinions; the *Siegel* case was actually affirmed from the bench.

Sec. 301.7602-1(c)(4), Appendix, *infra.* An investigation involving a special agent is generally a joint investigation with a revenue agent,[6] and the presence of the special agent merely indicates that the Service suspects the existence of civil or criminal fraud. Such an investigation could end with a determination of no deficiency, or, if a deficiency were found, there could be a recommendation for the imposition of either civil or criminal fraud penalties, or both, or neither. *Boren* v. *Tucker, supra.*

Nor do cases dealing with summonses issued after a taxpayer has been indicted, relied upon by the instant taxpayers (Br. 21-22), support their position. The principal case in this area is *United States* v. *O'Connor*, 118 F. Supp. 248 (Mass.). That case was considered at length and distinguished by this Court in *Boren* v. *Tucker, supra,* pointing out (239 F. 2d pp. 772-773):

> The facts in the O'Connor case were vastly different from those here present. To list a few:
>
> 1. The taxpayer there was under indictment.
>
> 2. The Special Agent there, who had the subpoena issued, had at that time finished his investigation, and "completed his report".
>
> 3. The Special Agent then had no matter concerning the taxpayer pending before him.
>
> 4. The Department of Justice, (not directly, but indirectly) had "suggested" that the Admin-

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[6] Cf. *Tillotson* v. *Boughner, supra,* where the Seventh Circuit rejected the same contention raised herein even though the investigation was being conducted *solely* by a special agent.

istrative subpoena be used by the Special Agent to aid the Government in the preparation of the pending criminal case. The Special Agent admitted that in issuing the subpoena, "*at least one* of his purposes was to aid the Department of Justice in the prosecution of the criminal case".

5. The Special Agent, in requesting the subpoena, was in no way performing *his* duties, nor following the orders of any superior in the Internal Revenue Bureau.

The absence of these same facts also serves to distinguish the case at bar from *O'Connor*. Indeed, in *In re Magnus, Mabee & Reynard, Inc., supra*, the taxpayer was actually indicted after the service of third party summonses but before compliance therewith.[7] The Second Circuit upheld the enforcement of the summonses, expressly following this Court's reasoning in the *Boren* opinion, and limited the *O'Connor* case and *Application of Myers*, 202 F. Supp. 212 (E.D. Pa.), strictly to their facts.

Taxpayers also mistakenly attempt to rely (Br. 11, 16) upon some language used by the Supreme Court in *Reisman* v. *Caplin*, 375 U.S. 440, 449. We submit that the Court was not purporting to approve the use of the instant contention as a defense to an enforcement action, but was merely enumerating types of defenses which had, at one time or another, been raised in the past. That this is the proper interpretation of the cited language is evident from the fact that the Court

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[7] This was also true in *Siegel* v. *Tyson, supra*.

cited *Boren* v. *Tucker*, *supra*, for this proposition, and in that case this Court rejected the defense.[8]

Nor is there any merit to taxpayers' contention (Br. 20-23) that enforcement of this summons affects any of their constitutional rights. The instant summons was served on the bank and it sought production of the bank's records (II R. 57-58). It is well settled that a taxpayer has no rights or privileges vis-a-vis such documents. *DeMasters* v. *Arend*, 313 F. 2d 79, 85 (fn. 11) (C.A. 9th), petition for certiorari dismissed, 375 U.S. 936; *Application of Cole*, 342 F. 2d 5, 7-8 (C.A. 2d), certiorari denied, 381 U.S. 950; *Zimmermann* v. *Wilson*, 105 F. 2d 583, 586 (C.A. 3d); *Schulze* v. *Rayunec*, 350 F. 2d 666, 668 (C.A. 7th), certiorari denied *sub nom. Boughner* v. *Schulze*, 382 U.S. 919.

The essential weakness of the taxpayers' position is high-lighted in their concession (Br. 4) that "the existence of some 'tax liability' regardless of the amount, * * * [is] an element of criminal income tax liability." It follows from this that an integral part of any administrative tax investigation, including one in which civil or criminal fraud is suspected, is the ascertainment of the correctness of the tax returns involved and the determination of the taxpayer's tax liabilities, at least to the extent of determining whether some deficiency exists. The Code authorizes the

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[8] Although it is clear that the denial of certiorari does not indicate Supreme Court approval of the lower court opinion, it might be noted that the denial of certiorari in *Tillotson* v. *Boughner*, *supra*, was subsequent to its decision in *Reisman*.

issuance of summonses for such purposes, and this would include that involved in the instant case.

II.

The Government Made A Sufficient Showing Of Relevancy and Materiality To Support the District Court's Determination That the Summons Should Be Enforced

The court below found that the Government "has presented a prima facie case of relevancy." (I R. 89.) This finding was manifestly a proper one, for the records sought pertain to financial transactions between the taxpayers and the bank. Taxpayers argue (Br. 17-18) that since money obtained from loans is not taxable income, these loan records would be irrelevant to the correctness of their tax returns. We submit this is not so. For example, there is the question of possible improper interest deductions adverted to by the taxpayers themselves in the footnote on page 18 of this brief. Moreover, it should be borne in mind that the individual taxpayer urged in the prior case before this Court that the corporation was merely his alter ego. *Wild* v. *Brewer*, 329 F. 2d 924 (dissent), certiorari denied, 379 U.S. 914. Thus the possibility arises that where the corporation has borrowed $75,000 but only shows loans of $6,000 on its books, the other $69,000 may have been used by the individual taxpayer for his own purposes. If this were so, and the corporation were repaying these loans, these repayments would be constructive dividends which the individual may not have reported. Furthermore, the financial statements submitted by the corporate taxpayer to the bank may well contain

information relevant to the correctness of its tax returns.

This Court has long held that the question of materiality and relevancy is strictly one of fact (*D. I. Operating Co.* v. *United States*, 321 F. 2d 586, 590; *Boren* v. *Tucker*, *supra*), and in the instant case the lower court considered Agent Brewer's uncontradicted affidavit (I R. 4-5) and testimony (II R. 47-53) in making its finding of materiality. We submit this finding of fact is supported by the facts in the record and the reasonable inference to be drawn therefrom, and it should be affirmed.[9]

III

There Was No Procedural Defect in the Commencement Of the Instant Action

In *United States* v. *Powell*, 379 U.S. 48, 58 (fn. 18), the Supreme Court said, "Because Section 7604 (a) contains no provision specifying the procedure to be followed in invoking the court's jurisdiction, the Federal Rules of Civil Procedure apply, *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731. The proceed-

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[9] It is difficult to see how the taxpayers can seriously contend (Br. 19-20) that the Government already has the records sought. It is obvious that the bank's central liability control (II R. 51) is some sore of summary showing nothing more than the number of loans and their amount; the records described in the summons (I R. 6) are those showing the basis for the granting of the loans, those showing amounts repaid, by whom, when, etc. To hold for the taxpayers on this point would be to say that where the Government has a business' balance sheet and income statement, it would not be entitled to look at the journals and ledgers which underlie them.

ings are instituted by filing a complaint, followed by answer and hearing." This is merely a restatement of Rule 1 of the Federal Rules of Civil Procedure, Appendix, *infra*, which sets forth the scope of the Rules, and a recognition by the Court of the absence of one of the exceptional circumstances of Rule 81 (a)(3), Appendix, *infra*, which would take such a case out from the Rules' application. However, as this Court recognized in *Chapman* v. *Goodman*, 219 F. 2d 802, 806, that same Rule 81(a)(3) gives the District Court the right to waive the Rules in a proceeding of this nature. Indeed, it is customary for this type of proceeding to be handled in an essentially summary manner, for Governmental requests for information should be handled with reasonable dispatch. See, e.g., *Chapman* v. *Goodman*, *supra; Boren* v. *Tucker*, *supra; United States* v. *Ryan*, 320 F. 2d 500, 502 (C.A. 6th), affirmed, 379 U.S. 61; see also *Porter* v. *Mereller*, 156 F. 2d 278, 280 (fn. 6) (C.A. 3d). Thus the court below, as in the *Chapman* case, *supra*, could be said to have partially laid aside the Rules as provided by Rule 81(a)(3), and so the commencement of this action by the filing of a petition was proper.[10]

Moreover, the lower court properly held that the instant petition could be treated as a complaint. Rules

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[10] It should be noted, (1) that Rule 81(a)(3) was not called to the attention of the Supreme Court by either party in the Powell case, (2) the applicability of the Federal Rules was not an issue in the *Powell* case, and (3) that this Court's 1942 decision in *Martin* antedated the 1946 amendment to that rule which clarified the authority of the district court to dispense with the Rules in enforcement proceedings. See Notes of Advisory Committee to Amendments to Rules.

2 and 3 of the Civil Rules, Appendix, *infra*, provide that a "civil action" shall be the one form of action to be brought, and it shall be commenced by filing a complaint. Rule 8(a), Appendix, *infra*, specifies that any pleading setting forth a claim for relief shall contain a short and plain jurisdictional statement, a short and plain statement of the claim showing the right to relief, and a demand for the relief sought. The petition filed by the Government to commence this action (I R. 1-3) conforms to these Rules, and, however denominated, it could be and was properly treated as a complaint. *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731, 734 (C.A. 9th).

CONCLUSION

For the reasons set forth above the order below should be affirmed.

Respectfully submitted,

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MARCH, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ..... day of ....., 1966.

BURTON BERKLEY,
Attorney

APPENDIX

Internal Revenue Code of 1954:

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

(26 U.S.C. 1958 ed., Sec. 7602.)

Treasury Regulations on Procedure and Administration (1954):

Sec. 301.7602-1 *Examination of books and witnesses.*

(a) *In general.* For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax (including any interest, additional amount, addition to the tax, or civil penalty) or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, any authorized officer or employee of the Internal Revenue Service may examine any books, papers, records or other data which may be relevant or material to such inquiry; and take such testimony of the person concerned, under oath, as may be relevant to such inquiry.

* * * *

(c) *Persons who may issue summons.* The following officers and employees of the Internal Revenue Service are authorized to issue a summons pursuant to sections 6420(e)(2), 6421(f)(2), and 7602—

* * * *

(4) Intelligence; Director; assistant director; assistant regional commissioners; executive assistants to assistant regional commissioner; chiefs, Review and Conference Staff; reviewer-conferees; chiefs and assistant chiefs of divisions, branches and sections; group supervisors; and special agents of the national, regional and district offices.

* * * *

(26 C.F.R., Sec. 301.7602-1)

Federal Rules of Civil Procedure:

Rule 1. [as amended December 29, 1948] Scope of Rules

These rules govern the procedure in the United States district courts in all suits of a civil nature whether cognizable as cases at law or in equity, with the exceptions stated in Rule 81. They shall be construed to secure the just, speedy, and inexpensive determination of every action.

Rule 2. One Form of Action

There shall be one form of action to be known as "civil action".

Rule 3. Commencement of Action

A civil action is commenced by filing a complaint with the court.

Rule 8. General Rules of Pleading

(a) *Claims for Relief.* A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief to which he deems himself entitled. Relief in the alternative or of several different types may be demanded.

* * * *

Rule 81. Applicability in General

(a) *To What Proceedings Applicable.*

* * * *

(3) [as amended December 29, 1948]. In proceedings under Title 9, U.S.C., relating to arbitration, or under the Act of May 20, 1926, c. 347, § 9 (44 Stat. 585), U.S.C., Title 45, § 159, relating to boards of arbitration of railway labor disputes, these rules apply to appeals, but otherwise only to the extent that matters of procedure are not provided for in those statutes. These rules apply (1) to proceedings to compel the giving of testimony or production of documents in accordance with a subpoena issued by an officer or agency of the United States under any statute of the United States except as otherwise provided by statute or by rules of the district court or by order of the court in the proceedings, and (2) to appeals in such proceedings.

* * * *

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